U.S. Department of Justice

United States Attorney

Eastern District of Pennsylvania

615 Chestnut Street

Suite 1250
Philadelphia, Pennsylvania 19106-4476
(215) 861-8200

March 16, 2005

U.S. REACHES AGREEMENT DESIGNED TO STOP FRAUD IN LENDING PRACTICES

PHILADELPHIA – United States Attorney Patrick L. Meehan today announced a Joint Agreement with Option One Mortgage Corporation ("Option One"). The Joint Agreement bolsters the company's efforts to root out fraud in its mortgage lending practices. And, the Joint Agreement addresses many of the problems identified by the Pennsylvania Department of Banking and The Reinvestment Fund in the recently released reports on foreclosures in Pennsylvania.

Under the Joint Agreement, Option One has put in place a package of reforms that will ensure that it identifies – and stops – fraudulent lending practices that victimize neighborhoods. These reforms will focus Option One's fraud detection systems, allowing the company to find concentrated fraud schemes, the very kind of schemes that destroy neighborhoods house by house, block by block.

"The reforms undertaken by Option One can be a model for other lenders," said Meehan. "Our office worked with Option One to ensure that these reforms will make a real difference."

"Predatory mortgage brokers, real estate agents, and appraisers know that large, nationwide mortgage lenders have not been paying sufficient attention to what is happening in individual neighborhoods," Meehan continued. "Lenders in California do not understand enough about what predators in Philadelphia neighborhoods are doing. Predators have taken advantage of that ignorance, victimizing neighborhoods and figuring that the lenders will not notice. The reforms will make certain that Option One notices."

The Reinvestment Fund report on foreclosures in Pennsylvania highlights the problem. The report identifies concentrated pockets of Pennsylvania – like Philadelphia and parts of the Poconos – that are being ravaged by foreclosures. The most startling statistic in the report is that almost 40% of non-prime loans originated in Philadelphia in 1998 were in foreclosure at some point between 2000 and 2003. Reforms similar to those Option One has adopted are needed industry wide so that lenders pick up the danger signs of concentrated problems. Without such reforms, such problems may go unnoticed until they become a crisis.

Included in the Banking Department's report are Recommendations For Pennsylvania Action, which include more targeted tracking of foreclosure "hot spots," tracking foreclosures by parties to loans (e.g., by mortgage broker, appraiser, and lender), and tracking and licensing individual mortgage brokers not just mortgage companies. These are the same reforms Option One has adopted as part of this agreement.

To combat unfair practices in the mortgage lending market, Meehan said the U.S. Attorney's Office has laid out a comprehensive plan of education, prosecution and remediation.

Investigations by the U.S. Attorney's Office discovered that independent mortgage brokers had, through several schemes, committed significant fraud in loans they submitted to Option One. Option One is one of the largest "nonprime" lenders in the nation. It typically makes loans to borrowers with impaired credit who can otherwise not obtain traditional "prime" loans. Option One principally originates loans that are submitted by independent mortgage brokers. This type of lending is called indirect or wholesale lending.

"As a result of inquiries by our office, Option One took a hard look at its fraud detection practices, which, in turn, led Option One to make important changes to those practices," Meehan said. "I am hopeful that other companies will follow Option One's lead. The government cannot stop mortgage fraud on its own. It needs the help of the industry."

A vital part of the reforms is targeted sampling. For example, Option One will now track delinquency and default rates by branch office, by loan officer, and by mortgage broker. Anomalies in these rates will trigger investigations. By focusing its monitoring efforts, Option One should be able to find fraud that is concentrated in particular neighborhoods. A predatory mortgage broker – who may do several hundred loans in one part of Allentown, for instance – can no longer hide his practices among the tens of thousands of loans Option One originates nationwide.

Key elements in the package of Option One reforms are as follows:

1. A reorganization of the corporate reporting structure now separates the production end of the business from the fraud detection end of the business. That is, those employees responsible for fraud detection report directly to the head of the company, and do not report to an officer responsible for sales.

2. The creation of company wide fraud detection committees, made up of the highest level company officers, has increased the profile of fraud detection at Option One and ensured the widespread dissemination of information about fraud detection.

3. Targeted reviews of Option One employees, Option One branch offices, and of third-parties doing business with Option One (e.g., brokers, closing agents, appraisers) has focused fraud detection and made it more likely that Option One will catch instances of fraud. Option One's sampling of potentially improper loans has become more surgical.

4. Changes in certain Option One products have eliminated some opportunities for fraud. Option One had loan products in which the company did not verify the source of funds used to close on a loan and in which Option One did not require that such funds be seasoned. Predators have manipulated sourcing and seasoning rules; they have funneled money to home buyers, for instance, knowing that Option One would not check to see where the money came from. Option One now requires sourcing and seasoning, except in limited circumstances. The change closes a door that led some to fraud.

5. Option One has improved its so-called Watch List and Barred Individuals List. These lists identify companies and individuals who have created problems for Option One. The lists might include, for instance, an individual who submitted fraudulent loans to Option One. The company requires its employees to consult these lists during the origination process to ensure that no entity or person on such list is submitting loans to Option One. That way, Option One prevents an individual predator from closing shop in Pennsylvania only to open a new one in New Jersey and continue submitting loans.

6. Option One has improved its training for its employees. It has beefed up the training it provides to help its employees recognize fraud.

To ensure its continued commitment to these reforms, Option One has agreed to provide two reports to the U.S. Attorney's Office confirming its compliance with the changes it has made to its internal procedures. And, recognizing the importance of counseling for individuals about to take out mortgage loans, Option One has voluntarily agreed to provide $100,000 to groups in the region involved in preventing predatory lending. The $100,000 will be divided as follows: $50,000 will go to the Philadelphia Don't Borrow Trouble Hotline, $25,000 will go to the Lehigh Valley Don't Borrow Trouble Hotline, and $25,000 will go to the suburban Philadelphia Don't Borrow Trouble Hotline.

The matter was investigated by the United States Attorney's Office's predatory lending initiative, led by Associate United States Attorney James G. Sheehan, and was handled by Assistant United States Attorney Michael S. Blume.

UNITED STATES ATTORNEY'S OFFICE
EASTERN DISTRICT, PENNSYLVANIA
Suite 1250, 615 Chestnut Street
Philadelphia, PA 19106

Contact: RICH MANIERI
Media Contact
215-861-8525

COPIES OF NEWS MEMOS AND RELATED DOCUMENTS CAN ALSO BE FOUND AT HTTP://WWW.USDOJ.GOV/USAO/PAE